54

MILBANK, TWEED, HADLEY & McCLOY LLP

INTERNATIONAL SQUARE BUILDING

1850 K STREET, NW, SUITE 1100

WASHINGTON, D.C. 20006

202-835-7500

FAX: 202-835-7586

NEW YORK
212-530-5000
FAX: 212-530-5219

LOS ANGELES
213-892-4000
FAX: 213-629-5063

PALO ALTO
650-739-7000
FAX: 650-739-7100

LONDON
44-207-448-3000
FAX: 44-207-448-3029

MUNICH
49-89-25559-3600
FAX: 49-89-25559-3700

FRANKFURT
49-69-7593-7170
FAX: 49-69-7593-8303

TOKYO
813-3504-1050
FAX: 813-3595-2790

HONG KONG
852-2971-4888
FAX: 852-2840-0792

SINGAPORE
65-6428-2400
FAX: 65-6428-2500

Rebecca Belmar
Litigation Case Manager
DIRECT DIAL NUMBER
(202) 835-7533
E-MAIL: RBELMAR@MILBANK.COM

May 9, 2006

Nancy M. Morris
Secretary
Securities and Exchange Commission
100 F. Street, NE
Washington, D.C. 20549

Re: In the Matter of the Application of Independent Broker Action Committee, Inc. For Stay of Commission Order Approving Proposed Rule Changes by the New York Stock Exchange LLC, File No. SR-NYSE-2004-05

Dear Ms. Morris:

This firm represents the New York Stock Exchange LLC ("NYSE") in connection with the above-captioned submissions to the Commission. Enclosed is the Declaration of Nancy Reich, Anne Allen and Louis Pastina with the original signature to be substituted in the NYSE's Memorandum of Law in Opposition to Independent Broker Action Committee's Motion For a Stay of Authorization for the New York Stock Exchange to Implement Phase 2 and Subsequent Phases of the Hybrid Market.

Respectfully submitted,

Rebecca Belmar

Rebecca Belmar
Litigation Case Manager

Enclosure

SECURITIES AND EXCHANGE COMMISSION

In the Matter of the Application of Independent Broker Action Committee, Inc. For Stay of Commission Order Approving Proposed Rule Changes by the New York Stock Exchange LLC	File No. SR-NYSE-2004-05

DECLARATION OF NANCY REICH, ANNE ALLEN AND LOUIS PASTINA

NANCY REICH, ANNE ALLEN, and LOUIS PASTINA declare, pursuant to 28 U.S.C. § 1746:

1. Nancy Reich is a Vice President and Associate General Counsel in the Office of the General Counsel of NYSE Group, Inc. ("NYSE Group"). New York Stock Exchange LLC ("NYSE" or "Exchange") is a wholly owned subsidiary of NYSE Group. Ms. Reich's responsibilities include overseeing the development of rules and interpretations governing trading on the Exchange floor.

2. Anne Allen is an Executive Vice President, Market Operations of NYSE Group. Ms. Allen's responsibilities include overseeing the operation of the systems and trading on the Exchange floor.

3. Louis Pastina is a Senior Vice President, Market Development of NYSE Group. Mr. Pastina is responsible for, among other things, managing the Hybrid Market project.

4. The facts set forth herein are based upon our personal knowledge, discussions with our colleagues and NYSE members, and NYSE documentation. We

make this declaration in support of NYSE's opposition to the request for a stay filed by Independent Broker Action Committee, Inc. ("IBAC").

INTRODUCTION

5. NYSE operates in a business environment that is experiencing significant and rapid technological change. In recent years, NYSE's customers have demanded increased choice and greater flexibility of execution methods. NYSE is developing and expanding enhanced electronic trading technology in response. The centerpiece of these efforts is the NYSE HYBRID MARKET^{SM} (the "Hybrid Market"), which NYSE first proposed in February 2004 in a proposed rule change, File No. SR-NYSE-2004-05.

6. NYSE faces significant competitive pressures from U.S.-based and non-U.S. based markets, ECNs and other alternative trading systems, market-makers, and other execution venues. NYSE competes with other market participants in a variety of ways, including, among other things, the quality of quoting and execution pricing, the speed of trade execution, and technological innovation. As a result of this competition, NYSE's share of trading in NYSE-listed securities declined in the period prior to commencement of the Hybrid Market.

7. Regulation NMS, adopted on April 6, 2005, will further increase competition between markets as a result of its order protection rules. The order protection rules apply only to orders that may be executed electronically. The Hybrid Market includes the automatic execution features necessary to assure that orders on the NYSE market receive the rules' protection.

8. The Hybrid Market is an important component of NYSE's response to these competitive and regulatory pressures. When successfully implemented, the Hybrid Market will change the way that securities are traded on NYSE's market and will differentiate NYSE from other trading venues. Any delay in implementing the Hybrid Market will adversely affect NYSE's operating results and its ability to compete.

9. The Hybrid Market is intended to integrate into one platform aspects of the physically convened auction market and automated electronic execution, preserving the advantages stemming from face-to-face interaction. Specialists will continue to provide liquidity and stability, in committing capital and meeting their regulatory obligations. Floor brokers will also continue to have a physical on-site presence that contributes to price discovery and improvement and the depth of market that are hallmarks of the Exchange's market. In the Hybrid Market, specialists and floor brokers will perform their functions both manually (as in the past) and electronically, using a variety of tools as described in NYSE's Proposed Rule Changes, and Amendments thereto, File No. SR-2004-05.

10. Four significant technological innovations of the Hybrid Market are:

a. NYSE Floor Broker Agency Interest Files^{SM}, which enable floor brokers to electronically represent agency interest at various prices at or outside the Exchange Best Bid or Offer (BBO) with respect to orders they are handling ("Broker Agency Files"). This capability is also referred to as "NYSE e-Quotes^{SM}" ("e-Quotes").

b. NYSE Specialist Interest Files^{SM}, which will allow specialists to electronically place their dealer interest within the Display Book system at prices at or outside the Exchange BBO ("Specialist Interest Files").

c. NYSE Specialist API℠, which is the name given to the functionality that permits specialists to maintain systems employing one or more algorithms to make trading and quoting decisions on behalf of the specialist. The system will transmit messages reflecting these decisions to post quotes and interact automatically with incoming orders via an Application Programmed Interface ("API"). The systems and algorithms are designed and developed by specialists.

d. Enhancements to the operation of NYSE DIRECT+® ("Direct+"), the Exchange's electronic execution facility.

PHASED-IN INTRODUCTION OF THE HYBRID MARKET

11. As the Securities and Exchange Commission (the "Commission") has approved, NYSE will introduce the various components of the Hybrid Market in several phases, each of which involves extensive testing and training prior to actual floor-wide implementation. *See* Securities Exchange Act Release No. 53539 (Mar. 22, 2006), 71 Fed. Reg.16353 (Mar. 31, 2006) ("Hybrid Market Order"). Each of these phases is being gradually rolled out in stages in order to test the systems and to identify and address any systemic problems in a live environment.

12. Phase 1 mainly affects floor brokers, providing agents with a new tool (e-Quotes) to express customer interest at or outside the Exchange BBO, to participate in executions. In addition, floor brokers were provided a reserve layering functionality for their e-Quotes. These features were designed with in-depth assistance by a broker-led technology committee. All of the functionality was reviewed with users and constituents, including floor brokers, within the NYSE committee process. Phase 1 also affects specialists, who are able to layer their interest at or outside the Exchange BBO, giving their bids and offers persistent standing. (This functionality is manual during Phase 1.)

13. Phase 1 began as a pilot, on December 15, 2005, following approval by the Commission. *See* Securities Exchange Act Release No. 52954 (Dec. 14, 2005), 70 Fed. Reg. 75519 (Dec. 20, 2005) (SR-NYSE-2005-87). The pilot, which lasted through the Commission's issuance of the Hybrid Market Order on March 22, 2006, was limited to 168 stocks. These pilot stocks, selected by NYSE in consultation with the Commission's Office of Economic Analysis, were widely distributed among specialists on the Exchange floor and included a range of securities in terms of anticipated volatility and trade volume. The roll-out of these pilot stocks was reflected in postings on the NYSE website, NYSE.com. By the conclusion of the pilot, software and systems required for e-Quote functionality had been rolled out for all of the pilot stocks and tested in the manner described in paragraphs 17 through 24 below. Software and systems for e-Quoting were installed for substantially all remaining stocks beginning on March 23, 2006. Installation was completed by April 5, 2006, when the first phase of the Hybrid Market became fully operational. The Market Performance Committee ("MPC"), comprised of floor brokers, specialists and representatives of institutional investors and allied members of the Exchange, as well as two of its subcommittees, the Technology Policy and Oversight Committee ("TPO"), and the Broker Technology Committee, each of which includes non-MPC member floor brokers, were updated as to the status of the pilot during this time period. Brendan R. Dowd, a partner of Warren P. Meyers (who purports to be the president and chairman of IBAC) is a member of the MPC. Gordon Charlop, also a partner of Warren Meyers, sits on the Broker Technology Committee and TPO.

14. Phase 2 introduces the API and algorithmic functionalities for specialists, who will use them to interact electronically with incoming orders and to quote electronically. Before any aspect of Phase 2 becomes operational, all of the following must first occur:

a. NYSE must install systems and software for APIs on the NYSE floor. There are numerous components that must be in place, including the Display Book®, the API Gateway, the incoming order dispenser, and the installation of additional flat panel screens on the trading floor.

b. Specialists must execute contracts with Securities Industry Automation Corp. ("SIAC") governing the location of their systems employing algorithms at SIAC. These agreements have not yet been entered into.

c. Specialists must sign certifications, in accordance with Rule 104(i), that the systems employing and algorithms comply with all NYSE rules and regulations and federal securities laws, including specialists' negative obligations.

d. NYSE and specialists must both test the systems that use algorithms, both in terms of the messages sent by specialists and the messages received by NYSE, to ensure that the algorithms comply with systems specifications governing their use. This will involve several layers of testing: unit testing, product testing, operations testing, fallback and recovery testing, and capacity testing.

All of these steps must take place before specialists will be permitted to use algorithms to quote and interact electronically with orders.

15. As in the case of Phase 1, Phase 2 will be implemented gradually. Once the Exchange completes tests with a specialist and notes that its system and algorithms are functioning properly, NYSE will permit the specialist to begin limited use, likely focusing on a single type of message, with respect to a single book of one to 20 stocks. (Specialists, by virtue of the Hybrid Market rules approved by the Commission, are limited to five message types.) If the specialist's system and algorithm perform

satisfactorily, the specialist's use of the API will expand to other types of messages, or other books. In this manner, the use of algorithms will gradually expand among specialists and posts, as NYSE gains experience in how the use of algorithms affects the Exchange's systems and market.

16. NYSE Regulation plans to issue guidance at or around the end of May 2006 to specialists and specialist firms reminding them that the negative obligation under the federal securities laws and NYSE Rule 104 will continue to apply in the Hybrid Market, and clarifying the Exchange's expectations with respect to compliance with that obligation.[1] After specialists' algorithms have been fully tested and have become operational, NYSE plans to continue implementation of the remaining Hybrid Market phases. The current plans for these phases are described in NYSE's Proposed Rule Changes and amendments thereto, File No. SR-2004-05, and the Hybrid Market Order.

NYSE EXPERIENCE DURING PHASE 1

17. To prepare floor brokers and specialists for their new tools in Phase 1, NYSE offered training that focused on e-Quotes. The training, which began in November 2005, consisted of three phases: An overview in a classroom setting (28 sessions offered), training with hand-held devices in a training environment (99 sessions offered), and "mock trading" using e-Quote technology with NYSE hand-held devices, performed on the Exchange floor after the close (39 sessions offered). Floor brokers

---

[1] The substance of the guidance will not be new, since the negative obligation has been part of the federal statutory scheme since 1934, and is well understood. Moreover, the Exchange does not intend to lift generally the size and other restrictions in Direct+ limiting automatic executions until the issuance of such guidance. To the extent that any algorithmic trading commences prior to the issuance of this guidance, trading will still continue to be largely manual in nature.

using proprietary (rather than NYSE) hand-held devices were able to simulate trades with the Display Book, using NYSE facilities for functional training provided by their vendor.

18. This formalized training program was very well attended: 547 floor brokers attended the hands-on training (including mock trading) and 580 attended the overview sessions. The formal training identified and addressed user and systems problems as they arose. During the pilot, NYSE also provided on-floor informal training and assistance to floor brokers, both during and after trading hours.

19. Installation of the systems and software for e-Quote capability proceeded smoothly, within normal expectations for the roll-out of new software. Each year, NYSE rolls out between 600 and 700 software releases. As in any software rollout, users — in this case the floor brokers and specialists — brought problems to the attention of the Supervisors on NYSE's floor. The identified problems, none of which were significant, were addressed and remedied pursuant to NYSE's established protocols and procedures.

20. Many of the problems with e-Quote technology arose because of floor brokers' lack of familiarity with the hand-held devices and their functionalities. For example, the first trade in the Phase 1 pilot was executed manually, rather than with the broker's hand-held device, because the device was not configured properly. To prevent this from recurring, NYSE officials arrived at the Exchange at 7:30 each morning to ascertain whether the devices were properly configured, and to reconfigure them on behalf of the brokers until they were able to do it themselves correctly.

21. One minor problem with the software involved the "cancel/replace feature" with respect to booked/capped orders and e-Quotes. Because of a software

anomaly, hand-held devices do not always reflect accurate "leaves" on the recall of an order, potentially leading to errors.[2] Member firms were notified of this particular problem in an e-Broker advisory as soon as it came to NYSE's attention, in February 2006. These advisories were broadcast real-time to the user community and were reiterated numerous times in numerous media. NYSE has provided instructions on how to avoid the problem when using the software — *i.e.*, a workaround — and expects to implement a software release that will eliminate the problem during the week of May 8, 2006.

22. No other problem identified by IBAC relates specifically to the e-Quote software or suggests that the e-Quote software has caused, or could cause, any significant problems. Various instances involving brief "freezes" of the specialists' Display Book do not indicate fundamental problems with the e-Quote technology. The Display Book for Wells Fargo, which froze on March 8, 2006 and did not recover within the normal period, was the only stock that was affected in this way by the release of Display Book software supporting e-Quotes. The cause of that problem was addressed quickly and has not recurred since.

23. The hand-held devices have permitted NYSE officials to communicate with brokers about other possible problems (not involving e-Quotes) to avoid any potential harm to investors. In the April 20 example referred to by IBAC (IBAC Memorandum at 7), NYSE used the hand-held devices to send a message to brokers about a possible problem with the DOT system; the hand-held devices enabled

---

2 This problem is referred to on page 7 of the IBAC Memorandum.

prompt dissemination of information about a possible problem to mitigate any effects related to that problem.

24. During April 2006, fewer than half of the 131 systems problems brought to the attention of Supervisors on the floor involved e-Quotes. Approximately half of those e-Quote problems (*i.e.*, 27) related to the cancel/replace feature. User error accounted for 11 reported problems, leaving a very small number of problems (relative to the number of orders and quoting activity) that were caused by e-Quote software or hardware. These numbers are extremely low in view of the magnitude and complexity of the software changes implemented in Phase 1.

25. The volume of activity on NYSE's floor has increased since Phase 1 of the Hybrid Market became fully functional, and the number of orders and quotes has significantly increased, especially with respect to the new tools made available to floor brokers and specialists as part of Phase 1. New messages enabled by the new technologies for the week of April 24, 2006 (the average daily results) were:

e-Quotes	7,548
Layers	9,519
Reserves	3,872
Replenishments	17,319
e-Quote Reports	42,294
g-Quotes[3]	53
s-Quotes	14,218

[3] The term "g-Quotes" refers to e-Quotes that are required to yield to other orders in compliance with Exchange Act Section 11(a)(1)(G).

c-Quotes[4]	30,753
Automated CAP Reports	246,497
Automated Stop Reports	24,826

As shown by this data, reflecting an average 396,899 new messages per day, Phase 1 of the Hybrid Market has successfully integrated into the daily workflow of the Exchange, moving it one step closer to the full Hybrid Market. Hundreds of thousands of messages due to Phase 1 changes have been generated, with few errors. In fact, the NYSE uncompared execution rate, around 0.07%, actually became lower during the implementation of Phase 1. No floor brokers have been "forced-in" on any trades, and all trades have cleared and settled appropriately.

EXCHANGE RULE 108

26. NYSE is amending Rule 108(a) to allow specialists to trade electronically on parity with floor brokers regardless of the specialists' position. Prior to the amendment, specialists were entitled to trade on parity with floor brokers only when liquidating or decreasing a position; specialists could trade on parity when establishing or increasing a position only when permitted by floor brokers.

27. NYSE has interpreted Rule 108(a) to mean that floor brokers permit specialists to trade on parity by not objecting or filing a complaint when the specialists trade on parity. It is often in the interest of floor brokers and their customers to allow specialists to trade on parity, as, for example, when customers want to participate in a transaction below a certain size or do not want to be the sole contra-party

4 The term "c-Quotes" refers to a specific type of percentage order, *i.e.*, "convert and parity, destabilizing, immediate or cancel." This type of order is also referred to as "CAP."

to an execution. In such cases, the customer is indifferent as to whether the party trading alongside is a specialist.

28. Amended Rule 108(a) will permit specialists using algorithms to trade on parity automatically when establishing or increasing their position. This amendment is necessitated by the reduction in human interaction resulting from electronic trading: Specialists will not have the ability to alert floor brokers that they are trading on parity, nor will floor brokers have the opportunity to object before the trade takes place. In order to meet their affirmative obligations in the hybrid market, specialists will have to send trading messages in response to orders. They are allowed to effect proprietary transactions, in accordance with Exchange Rules and federal securities laws, in order to meet the immediate and reasonably anticipated needs of the market.

29. Under the amended rule, floor brokers will be able to exclude specialists from trading on parity consistent with their customers' instructions and their best execution obligations. Floor brokers can send their orders through SuperDot®, enter a Direct+ order, or hit a bid/take an offer. If floor brokers use e-Quotes, however, they are implicitly granting specialists permission to trade on parity when the specialists are establishing or increasing their position. This is similar to the permission to trade on parity that floor brokers give specialists in connection with the execution of percentage orders.

DISCRETIONARY E-QUOTES

30. NYSE is planning to provide floor brokers with an additional tool in the Hybrid Market for leveraging their judgment in quoting and trading on behalf of their customers. This new functionality consists of the ability to enter discretionary

trading and pegging (discretionary quoting) instructions for their e-Quotes. These "d-Quotes" are the subject of a proposed rule filing that NYSE has discussed with the Commission and will file shortly.

31. In the mostly manual pre-Hybrid Market, floor brokers had an opportunity to make trading decisions with respect to arriving orders. In a more electronic trading environment, a floor broker may not always have that opportunity. Although e-Quotes enable floor brokers' customer interest to participate in automatic executions at the Exchange BBO and in sweeps, they do not initiate trades with incoming orders at prices better than the BBO. In other words, e-Quotes currently do not provide floor brokers with the means to express a price range within which they are willing to actively trade. Thus, the proposed changes will provide floor brokers with the ability not only to quote in an attempt to draw interest, but at the same time to initiate trades with contra-side interest able to trade at prices at or within the BBO. Neither the specialist, nor the specialist system employing algorithms, will have access to the discretionary instructions entered by floor brokers. E-Quotes are also not provided to the specialists' algorithms.

32. NYSE reviewed the d-Quote concept with its constituents. The Broker Technology Committee assisted greatly in the design of the functionality. The original design for the pegging function was that it would allow only for a discretionary price range. During the discussions with floor brokers regarding pegging, floor brokers advocated for a discretionary size range as well. In response to the floor brokers' concerns, this function was added to the d-Quote proposal and the proposed new rule will allow floor brokers to peg both e- and d-Quotes according to *size* and *price* functions.

33. On March 29, 2006, the concept of d-Quotes was presented for approval to NYSE's Market Performance Committee. Brendan Dowd was present at the March 29 meeting and stated that he had seen NYSE's presentation on d-Quotes. Following a discussion concerning the need to review and discuss many questions and scenarios as to how d-Quotes would be implemented, the Market Performance Committee (including the floor brokers on the committee) voted in favor of the proposal. The chairman of the Market Performance Committee, Robert H. McCooey, Jr., encouraged the members of the committee to meet in groups, either large or small, to work out any issues that were raised in the discussion.

We declare under penalty of perjury that the foregoing is true and correct.

Executed on May 5, 2006
in New York, New York.

Nancy Reich
NANCY REICH

Anne E Allen
ANNE ALLEN

Louis Pastina
LOUIS PASTINA